Highlights

Financial

	1985	1984
Revenues	$ 422,468	$ 5,800
Cash flow (deficiency) from operations	(16,574)	(325,324)
Net loss	134,528	495,384
Capital expenditures	2,653,182	792,150
Total assets	4,772,435	4,646,119
Shareholder's equity	4,370,088	4,504,616

Operating

Production - Barrels of oil per day		
January 1	—	—
December 31	55	—
Wells drilled		
Gross	13	3
Net	6.2	0.65
Success rate	92%	0%
Land Holdings - acres		
Gross	19,529	1,280
Net	13,436	532
Proved reserves before royalties		
Crude oil (barrels)	375,600	—

Metric Conversion Factors

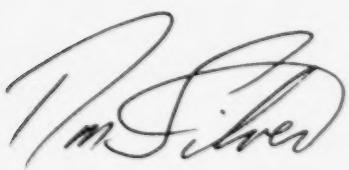
1 cubic metre	*= 6.29 barrels petroleum liquid (oil)*
	= 35.49 cubic feet natural gas
1 hectare	*= 2.47 acres*
1 kilometer	*= 0.62 miles*

Chairman's Remarks

The Corporation completed its organizational year in 1984 in a strong position to begin exploration and development activities in 1985. The results of 1985 illustrate that Manitoba Oil and Gas is a corporation with a bright future. The acquisition of a solid land base, together with initial success in exploration and development activity during the year provides an early indication of the Company's ability to find new oil reserves in the province and to spur economic activity.

Our excellent performance is no accident. The employees of Manitoba Oil and Gas, in concert with our joint venture partners, apply their professional expertise with dedication and skill. The Corporation is moving quickly and ambitiously to take advantage of perceived opportunities and to encourage new entrants to the Manitoba oil industry. The effectiveness of these efforts will serve to maximize returns on the monies invested on behalf of the people of Manitoba as well as to increase the associated economic spin-offs.

The 1986 world oil price outlook will put pressure on Manitoba Oil and Gas to maintain a high level of exploration and development activity relative to the economic conditions which may prevail. The continued diligence and professionalism of our employees, together with sound guidance provided by the Corporation's Board of Directors will be necessary to achieve our goals in the coming year.



Robert M. Silver

Chairman

President's Message

During 1985 the Corporation made positive strides towards reaching its long term goal of becoming a successful, profitable oil company while at the same time expanding Manitoba's known petroleum resource base.

During the year the Corporation participated in drilling thirteen test wells and two recompletions. Twelve of the test wells were cased as potential oil wells and the recompletions were put on pump. The Company's share of production in these wells, averaging 45 percent of gross production, will result in significant contributions to cash flow in future years.

Proved reserves of crude oil delineated and owned by the Corporation are estimated to be 375,600 barrels. The cost of finding and developing these reserves is under $ 6.00 per barrel which is well within the range established as part of the initial objectives set forth by the Company.

The acquisition of a mineral rights base upon which future drilling programs will be developed is important to the Company's success. We are pleased to report that the Company has been successful in acquiring over 13,000 net acres of prospective mineral rights in Manitoba.

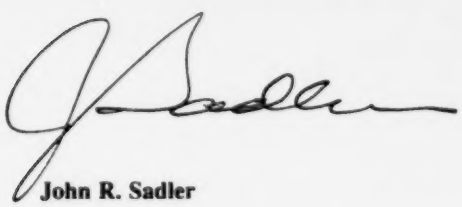
In order to better position ourselves to exploit opportunities and influence growth, the Company intends to operate some of its own wells in 1986. During these formative first two years, the combination of a small experienced group of employees, well defined objectives and adequate financial backing have served to position the Corporation to take advantage of future growth opportunities. As cash flow builds from lower-risk drilling programs in currently productive areas and formations the Corporation will step up exploration activities designed to discover new fields in currently non-productive areas in the province.

The OPEC cartel shows signs of disarray as some members seek a larger share of the market through discount pricing. This augers for a more volatile and downward

trending price behavior over the next several years. Fortunately, the cost of finding and producing oil in Manitoba is among the lowest in Canada and production should remain economic in the $20 to $25 per barrel price range. However, if prices decline much below this range, low productivity wells will become uneconomic and discretionary cash flow available for reinvestment by the industry will be substantially reduced.

Drilling activity in Manitoba reached a thirty year high of 268 wells in 1985; with activity shifting from the Waskada area to the Virden and Daly/Ebor areas where a new discovery in the Bakken formation was announced just prior to year end.

In spite of short-term oil price uncertainties, we look forward to making a notable contribution to overall industry activity in Manitoba in 1986.



John R. Sadler

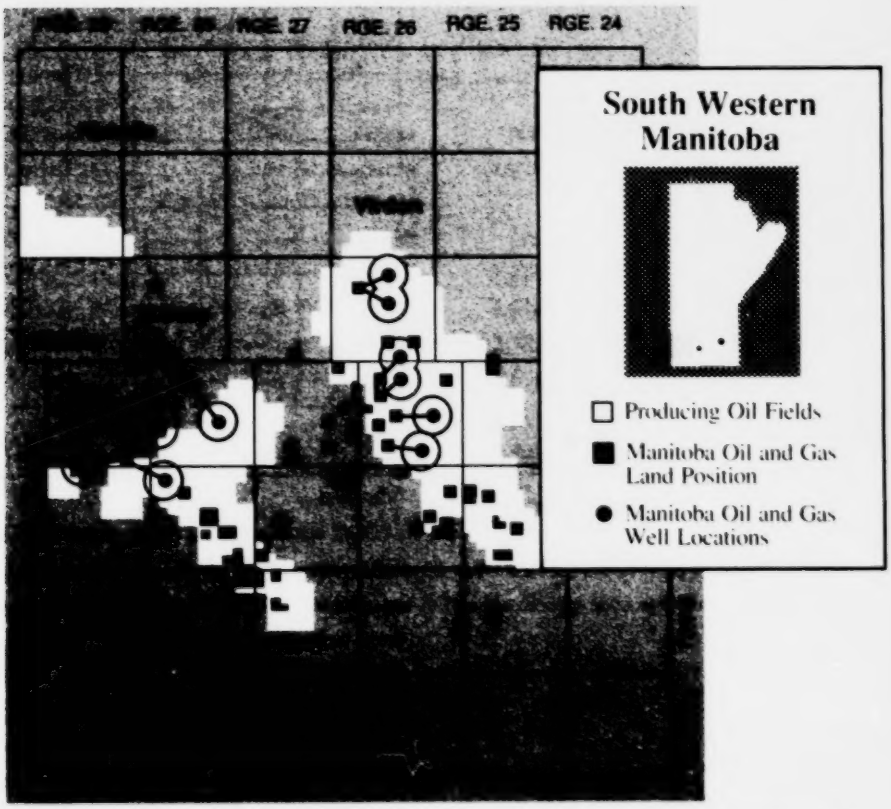
President

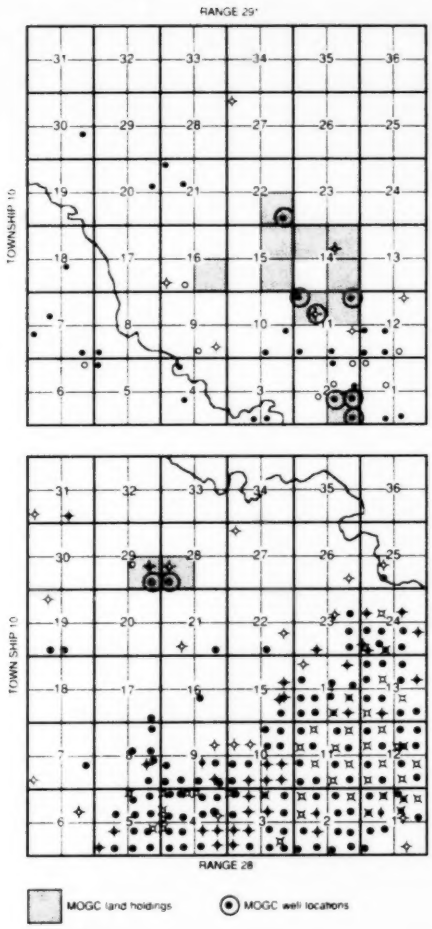
Exploration and Development

As a result of successful internal prospect generation, land acquisition and joint venture drilling, MOGC realized its first production from the North Virden Scallion and Ebor areas of Manitoba in early 1985. Both prospects were acquired in the October, 1984 provincial Crown land sale. The Company has a maximum 50 percent interest in all prospects which have been drilled to date, reflecting a corporate philosophy centred on spreading risk and encouraging active industry participation in internally generated prospects.

Throughout the year, MOGC continued to develop prospects primarily for the Lodgepole Formation in various areas of the province and participated in land acquisition and drilling projects with other industry partners.

The Company has also been successful in acquiring land on the active Bakken trend which has been the focus of attention after a September discovery in the West Daly area.





North Ebor

The Company participated in the drilling of seven wells (6 oil, 1 dry) in the North Ebor area during 1985. MOGC has a 40-50 percent working interest in these wells and has interests ranging from 40 percent to 100 percent in 800 adjacent acres. Further exploratory and development drilling is planned for the area during 1986.

North Daly

The Company participated in the successful recompletions of two wells in the North Daly area during 1985. MOGC has a 25 percent working interest in these wells and interests ranging from 37.5 percent to 50 percent in the remaining undrilled spacing units. Further drilling is planned for 1986 where the Company has negotiated a two section Farmout on adjacent acreage for a 25 percent interest in the lands and wells.

Virden

MOGC was successful in acquiring other highly prospective acreage during 1985 derived from various internally generated prospects. The Company participated in the drilling of an additional six wells on these prospects (6 oil, 0 dry). The participation rate in all of these wells was 50 percent. Two of these wells, located on MOGC lands in the North Virden area, are expected to be included in the proposed North Virden Scallion Unit No. 2, with ICG Resources as designated operator.

The remaining four wells are all offsets to mature producing areas of the main Virden field and have extended the productive boundaries of known accumulations.

Further offset locations have been identified from these extension wells for drilling in 1986. The Company holds a sizable acreage position on similar pool extension prospects in the Virden area.

Land

During 1985 the Company significantly increased its land position in Manitoba. Net land holdings increased from 532 acres a year ago to 13,436 acres by December, 1985. Approximately $700,000 was spent acquiring mineral rights during the year which will provide the basis for exploration and development programs for the next two to three years.

Land Summary

As at December 31, 1985

	1985		1984	
Prospect Areas	**Gross Acres**	**Net Acres**	Gross Acres	Net Acres
N. Daly	**320**	**125**	—	—
N. Ebor	**1,440**	**1,200**	—	—
Pierson	**3,180**	**1,670**	40	10
Virden	**4,850**	**2,785**	280	130
Others	**9,739**	**7,656**	960	392
Total	**19,529**	**13,436**	1,280	532

Drilling

During 1985 MOGC participated in drilling 13 wells (6.2 net) with a 92 percent success rate. In addition, the Company participated in two successful recompletions (0.5 net) of previously uneconomic oil wells.

Drilling results are summarized as follows:

	1985				1984	
	Exploratory		Development		Exploratory	
	Gross	Net	Gross	Net	Gross	Net
Oil wells	**3.0**	**1.5**	**9.0**	**4.2**	—	—
Dry holes	**1.0**	**0.5**	**—**	**—**	3.0	0.65
Total	**4.0**	**2.0**	**9.0**	**4.2**	3.0	0.65

Production

During 1985 the Corporation realized its first crude oil production and, by year end, was producing approximately 55 barrels of oil per day. This represents the Company's net participation in twelve of fourteen wells cased during the year. Two additional wells were in the completion stages at December 31st.

Cumulative production of 7,500 barrels for the year reflects the fact that most wells were completed during the latter months of 1985. In addition, production on many wells was subject to interruptions to permit more complete testing and, as a result, were typically not producing for a full month.

Reserves

The Company's reserves were reviewed and evaluated by Esau, Finn and Associates Ltd., independent petroleum engineers.

MOGC's 1985 drilling program resulted in the discovery of 383,100 barrels of crude oil which, after deducting 1985 production, leaves a year end reserves base of 375,600 barrels. The majority of the Company's reserves are located in the Virden and Ebor areas of Manitoba.

Pipeline

Construction of the Waskada-Cromer Pipeline was in the completion stages a year ago and began operating in January, 1985. This pipeline, in which the Company holds a ten percent interest, transports crude oil from the Waskada field to the Interprovincial Pipeline.

Management Discussion

Overview

1985 represents the second year of operations for the Company. Efforts during the first year were directed primarily at establishing a solid corporate organization and forging an initial exploration and development program. There was minimal involvement in drilling activity during 1984 (0.65 net wells drilled). A comparative evaluation of the first two years of operations should be made within this context in order to provide a meaningful perspective for assessment.

The Company has experienced significant growth during the year which has been accomplished by means of a carefully planned strategy; balancing the importance of investing in longer term growth opportunities against profitability in the near term.

Operations

1985 was an historic year for the Company in many respects. A successful drilling program led to its first crude oil sales and the establishment of an important reserves base which will make a positive impact on cash flow in the years to come. Five of the wells drilled during the year are located on land acquired during 1984, which, combined with technical knowledge gained through seismic programs and other geological studies, reflects the Company's early success in establishing a land base.

During the year, the Company participated in drilling 13 wells (6.2 net) and two successful recompletions (0.5 net) which generated crude oil revenues of $263,577. Additional revenues of $165,780 were realized from the Company's ten percent interest in the Waskada-Cromer oil pipeline located in the southwest corner of Manitoba.

1985 was also an important year for the petroleum industry as a whole. The dismantlement of the National Energy Program, in place for the last several years, has resulted in a more positive and optimistic attitude in many companies. At the same time, it has also meant exposure to a more volatile pricing and marketing environment which reinforces the need for sound exploration and development programs. Manitoba Oil and Gas will seek to attract industry partners to participate in Company-operated wells over the next twelve months. The focus will remain on development drilling with exploration activity, an important consideration for long-term growth, dictated largely by future cash flows from operations.

Outlook for 1986

In spite of recent declines in world oil prices the Company remains optimistic about its future. The Company's relatively low finding costs experienced to date, along with current financing arrangements, should provide opportunities for profitable investment and a successful operating program in 1986.

Auditor's Report

To the Shareholders of The Manitoba Oil and Gas Corporation

We have examined the balance sheet of The Manitoba Oil and Gas Corporation as at December 31, 1985 and the statement of operations and deficit and changes in cash resources for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the Company as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Deloitte Haskins & Sells

March 18, 1986

Chartered Accountants

Manitoba
Oil and Gas
Corporation

Balance Sheet

As at December 31, 1985

		1985		1984
Assets				
Current assets				
Cash	$	**139,373**	$	35,937
Funds held in trust (note 4)		**1,100,000**		3,950,000
Accounts receivable		**78,591**		16,845
Drilling advances		**255,320**		13,721
Inventories		**34,640**		—
Deposits and prepaid expenses		**7,193**		7,526
	$	**1,615,117**	$	4,024,029
Property and equipment less accumulated depletion, depreciation and amortization (note 3)	$	**3,157,318**	$	622,090
	$	**4,772,435**	$	4,646,119
Liabilities				
Accounts payable	$	**402,347**	$	141,503
Equity, Province of Manitoba				
Share capital (note 4)	$	**5,000,000**	$	5,000,000
Deficit		**629,912**		495,384
	$	**4,370,088**	$	4,504,616
	$	**4,772,435**	$	4,646,119

Approved on Behalf of the Board

Director

Director

The accompanying notes are an integral part of this Balance Sheet.

Manitoba
Oil and Gas
Corporation

Statement of Operations and Deficit

For the Year Ended December 31, 1985

		1985		1984
Revenue				
Petroleum sales	$	263,577	$	—
Less: Royalties		23,608		—
	$	239,969	$	—
Pipeline fees		165,780		—
Interest and other income		16,719		5,800
	$	422,468		5,800
Expenses				
Production and operating	$	91,192	$	—
General and administrative		347,850		226,538
Depletion, depreciation and amortization		117,954		11,984
	$	556,996	$	238,522
Loss from operations	$	134,528	$	232,722
Write-down of oil and gas properties (note 5)	$	—	$	158,076
Organization costs		—		104,586
Net loss for the year	$	134,528	$	495,384
Deficit, beginning of year	$	495,384	$	—
Deficit, end of year	$	629,912	$	495,384

The accompanying notes are an integral part of this statement.

Manitoba
Oil and Gas
Corporation

Statement of Changes in Cash Resources
For the Year Ended December 31, 1985

		1985		1984
Cash flow (deficiency) from operations				
Loss from operations	$	(134,528)	$	(495,384)
Items not affecting cash -				
Depletion, depreciation & amortization		117,954		11,984
Write-down of oil and gas properties		—		158,076
Cash flow (deficiency)before working capital changes	$	(16,574)	$	(325,324)
(Increases) decreases in operating working capital -				
Accounts receivable	$	(57,099)	$	(16,845)
Inventory		(34,640)		—
Deposits & prepaid expenses		333		(7,526)
Accounts payable		14,697		31,503
	$	(76,709)	$	7,132
	$	(93,283)	$	(318,192)
Capital expenditures				
Property & equipment	$	(2,653,281)	$	(695,871)
Financing activity				
Issuance of share capital	$	—	$	5,000,000
Cash (required) provided	$	(2,746,564)	$	3,985,937
Cash, beginning of year	$	3,985,937	$	—
Cash, end of year	$	1,239,373	$	3,985,937

(1) "Cash" comprises cash and funds held in trust.

(2) 1984 balances, originally presented on a working capital basis, have been restated to conform to the 1985 presentation.

The accompanying notes are an integral part of this statement.

Notes to Financial Statements
December 31, 1985

1. Summary of Significant Accounting Policies

The accompanying financial statements have been prepared by management in accordance with generally accepted accounting principles. The Corporation's significant accounting policies are summarized below.

Joint Ventures

Substantially all of the Corporation's exploration activities are conducted jointly with others. These financial statements reflect only the Corporation's proportionate interest in such activities.

Full Cost Method of Accounting

The Corporation follows the full cost method of accounting for oil and gas operations wherein all costs related to the exploration for and development of oil and gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals on undeveloped properties, costs of drilling both productive and non-productive wells and all technical and administrative overhead directly associated with exploration and development activities. Such costs are limited to the future net revenue from estimated production of proved reserves and the estimated fair market value of unproved properties.

Depletion, Depreciation and Amortization

Depletion of oil and gas properties and depreciation of production equipment and facilities is calculated using the unit-of-production method based on estimated proved reserves of oil and gas. Costs of acquiring and evaluating unproved properties are excluded from capitalized costs to be depleted until it is determined whether or not proved reserves are attributed to the properties or impairment in value has occurred.

Depreciation on other equipment is calculated on the declining balance basis at rates ranging from twenty to twenty-five percent. Leasehold improvements are amortized over the remaining term of the lease plus one renewal period.

2. Status of the Corporation

The Manitoba Oil and Gas Corporation was established as a Crown Corporation under the Manitoba Oil and Gas Corporation Act, Bill 4, in 1983. Under the provisions of its Act, the Corporation conducts activities to promote exploration and development of oil and gas as a direct participant in the industry.

3. Property and Equipment

	1985			1984
	Cost	Accumulated Depreciation Depletion & Amortization	Net Book Value	Net Book Value
Petroleum and natural gas properties including exploration & development thereon	$ 2,496,178	$ 191,916	$ 2,304,262	$ 190,380
Pipeline investment	492,233	54,410	437,823	388,584
Production equipment	209,735	5,000	204,735	—
Other	247,186	36,688	210,498	43,126
	$ 3,445,332	$ 288,014	$ 3,157,318	$ 622,090

4. Share Capital

As a Crown corporation, the Corporation issues share certificates to the Minister of Finance in exchange for equity financing. Proceeds available to the Corporation in respect of shares issued are held in trust by the Minister to be advanced as funds are required to finance operations. Undisbursed funds held in trust are non interest-bearing to the Corporation.

		1985		1984
Authorized				
200,000 shares, maximum consideration	**$**	**20,000,000**	$	20,000,000
Issued				
50,000 shares	**$**	**5,000,000**	$	5,000,000
Proceeds advanced		**3,900,000**		1,050,000
Funds held in trust	**$**	**1,100,000**	$	3,950,000

5. Write-down of Oil and Gas Properties

Under generally accepted accounting principles, the capitalized cost of oil and gas properties is limited to the present value of future net revenues from estimated production of reserves. During 1984, the first year of operations, the Company participated in a total of three drilling ventures which proved to be unsuccessful. As a result of the failure to find commercial reserves prior to year end, all related costs were written off.

6. Commitments

Future minimum lease payments in respect of office premises and equipment aggregate $65,000 over the next five years.

7. Subsequent Event

On January 9, 1986 The Corporation issued 50,000 shares of capital stock to the Minister of Finance for $5,000,000.

8. Comparative Figures

Certain of the prior year's comparative figures have been reclassified to conform to the current year's presentation.